Accounting Standards Board

Newsletter July 2021 Edition

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New from the ASB

New pronouncements

The ASB met on the 24th of June and approved the following pronouncements:

- Interpretation of the Standards of GRAP on *The Effect of Past Decisions on Materiality.* The effective date is 1 April 2023 and earlier application is encouraged.
- Research Paper on *The Desktop Review of Cash Flow Statements Presented in the Financial Statements.*

Reviews completed

The review of Directive 12 on *The Selection of an Appropriate Reporting Framework by Public Entities* was completed. The Board agreed that no changes are needed to Directive 12, but that certain issues would be included in communication material to be developed by the Secretariat. The findings of the review would be included in a Research Paper.

Standard-setting

The Prefaces to the Standards, Interpretations and Directives have been combined into a single Preface. The content of the Preface was reviewed and it was agreed that the material relating to the ASB's standard-setting process would be included in a "due process" Handbook. The draft Handbook will be developed in the next quarter and published for comment.

Access the meeting highlights here.

New FAQ on disclosures about Standards that are not yet effective

The ASB issued a new FAQ on disclosures related to Standards of GRAP that have not yet been approved by the Minister of Finance for implementation.

Once the Standards of GRAP are issued by the ASB, the Minister of Finance approves their implementation by publishing their effective date in a Gazette.

Paragraphs 32 and 33 of GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors* require entities to disclose information about Standards of GRAP that are not yet effective. Much of this information is about when an entity plans to adopt the Standard and the potential impact on the financial statements.

For those Standards where the Minister of Finance has not determined an effective date, it may not be possible to comply fully with the disclosures in paragraphs 32 and 33. As a result, entities should consider whether any information disclosed about these Standards is relevant to users' needs.

Access the FAQs.

Does hindsight affect prior years' financial statements?

Hindsight means that you only understand an event or situation after it has happened.

Preparing financial statements is not always an exact science. Judgements and assumptions often need to be made about how to account for transactions and events. In preparing the financial statements, an entity uses information (a) available when the financial statements were authorised for issue; and (b) that could reasonably have been expected that it would be considered in preparing financial statements. If new information becomes known in a subsequent period, or an entity's intention changes, the accounting would not necessarily be changed. This is particularly in the case of hindsight.

GRAP 3.55 indicates the following: "Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period." This means that an entity will not change prior year accounting because of new facts and circumstances that become known.

Consider the following examples:

- Classification of investment property – A municipality owns an office building which it uses in 20X0 as its head office. As a result, it classifies the building as property, plant and equipment. After the financial statements are authorised for issue, the municipality decides to lease the majority of the building to a provincial public entity. In 20X1, the building is classified as investment property. The classification of assets is based on their use (or intended use) at a point in time. As a result, the comparative information is not changed to reflect the different classification in 20X1.
- Classification of loan receivable as current or non-current – A public entity provides a loan to a technology innovation start-up. The loan is repayable in equal monthly installments plus interest once the start-up achieves a certain level of profitability. The loan is callable (i.e. capital and interest becomes repayable on demand) if the entity's solvency ratio reaches a specified level. In year 20X0, the public entity was of the view that the entity would only become profitable in 20X3 and classified the loan as non-current. In 20X1, there was an economic crisis, which meant that the start-up had to take on additional debt and the solvency ratio deteriorated. This resulted in the loan being called and repaid in full in 20X1. Although the loan was settled in 20X1, this does not mean that the classification as non-current in 20X0 was incorrect.

For more, read GRAP 3 on *Accounting Policies, Changes in Accounting Estimates and Errors* here.

IPSASB proposes measuring assets at "current operational value" – what is it?

The IPSASB issued ED 77 on *Measurement* (ED 189 locally) for comment. ED 77 outlines possible measurement bases to be used for assets and liabilities in the public sector and explains how they should be applied.

For assets, the IPSASB proposes the following measurement bases:

- Historical cost.
- Fair value.
- Current operational value.

The introduction of fair value in ED 77 meant that changes were needed to the Conceptual Framework.

These changes include adding fair value as a measurement basis, but also changing "replacement cost" to "current operational value".

Fair value represents the price an entity would receive to sell an asset. As public sector entities do not often sell their assets, the IPSASB confirmed the need for a current value measurement basis that reflects what an entity would pay to replace an asset. When the IPSASB consulted on initial approaches to measurement, respondents indicated that replacement cost could not be both a measurement basis on its own, as well as a means of calculating fair value when using the "cost approach". "Replacement cost" and the "cost approach" in fair value are most commonly used to measure non-financial assets. It was clear, however, that a new concept was needed. The IPSASB developed "current operational value" as a result.

As "current operational value" is new, there are various issues to consider. The table below outlines the previous and new definitions (own emphasis added).

Replacement cost	**Current operational value**	
Previous Conceptual Framework	*Proposed revision*	
The most economic cost required for the entity to replace the service potential of an asset (including the amount that an entity will receive from its disposal at the end of its life) at the reporting date.	Current operational value is the value of an asset used to achieve the entity's service delivery objectives at the measurement date.	**Measurement basis**
	Cost approach is a measurement technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).	**Measurement technique**

Conceptual difference or not?

Replacement cost focuses on the cost of replacing the service potential of an asset, while current operational value measures the value of an asset used to achieve service delivery objectives. Replacement cost measures how much it would cost to replace an asset that provides specified and quantifiable outputs, e.g. water infrastructure that is required to produce X number of kilolitres per hour. Current operational value seems to extend beyond tangible, quantifiable measures by focusing on the achievement of service delivery objectives more broadly. This seems to include other performance measures within the valuation of an asset.

There is currently no specific measurement basis in the valuation community that specifically measures an asset's value to achieve service delivery objectives. The valuation community is familiar with, and uses, replacement cost. The change to current operational value may result in increased subjectivity in measurement, and there may be no existing practice on which to base this measurement.

The cost approach uses replacement cost?

In terms of measuring current operational value, there are three techniques that could be used – a market approach[1], an income approach[2], and a cost approach (as described in the table above). In the context of using "current operational value", the cost approach will most likely be used to measure assets that contribute to an entity's operational capacity[3]. As entities in the public sector most often use their assets to deliver services, it is likely that the cost approach will be used more frequently than the other techniques.

The cost approach directly refers to using replacement cost. It would seem that although current operational value has been used as the overall measurement basis, the actual outcome of the measurement may be no different when replacement cost is used.

While there are specific aspects that need to be debated in both current operational value as a measurement basis and using the cost approach as a measurement technique, a broader question to consider is whether the IPSASB is in a different position to earlier consultations or not.

Have your say …

We look forward to hearing your views on this topic. Access the IPSASB's Exposure Drafts on our website. The comment deadline is 1 October 2021.

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